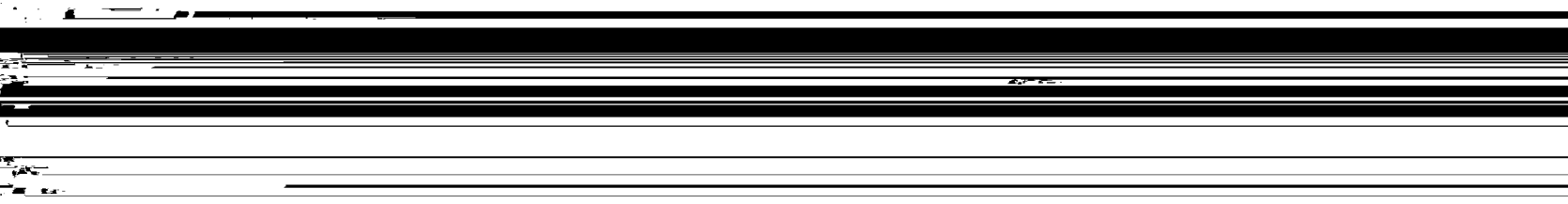
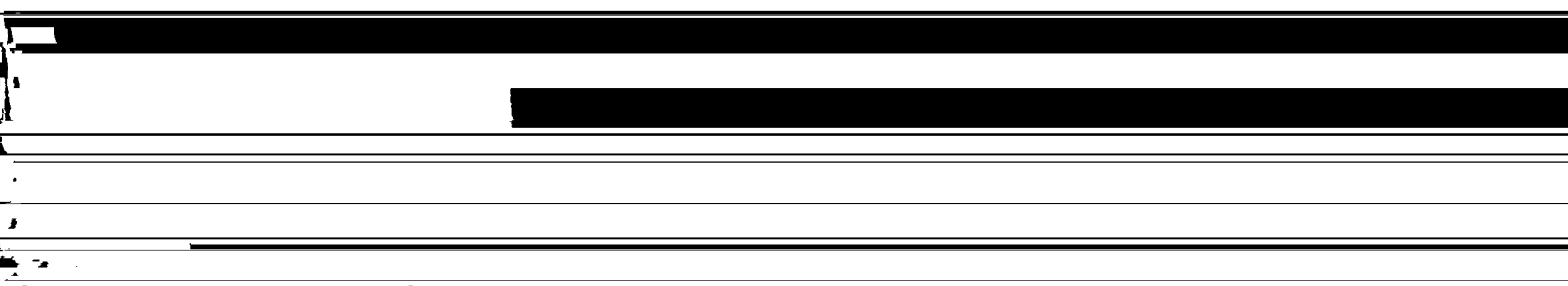
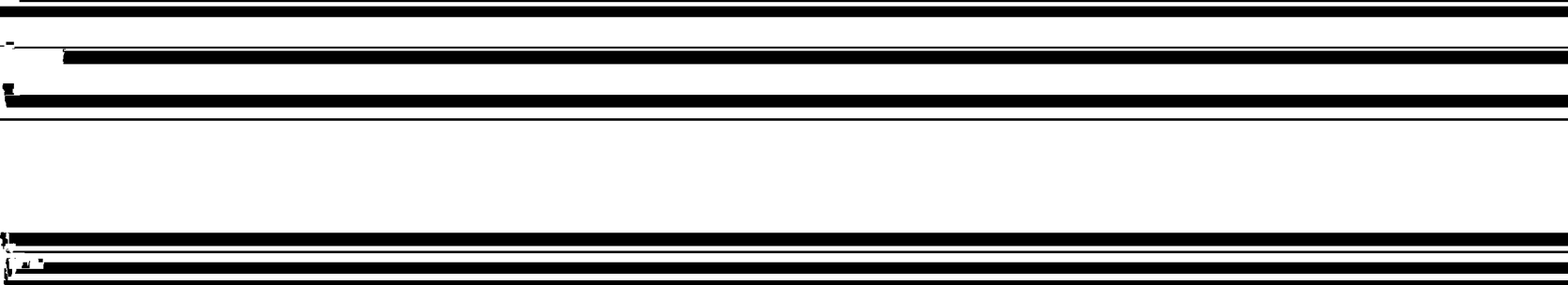
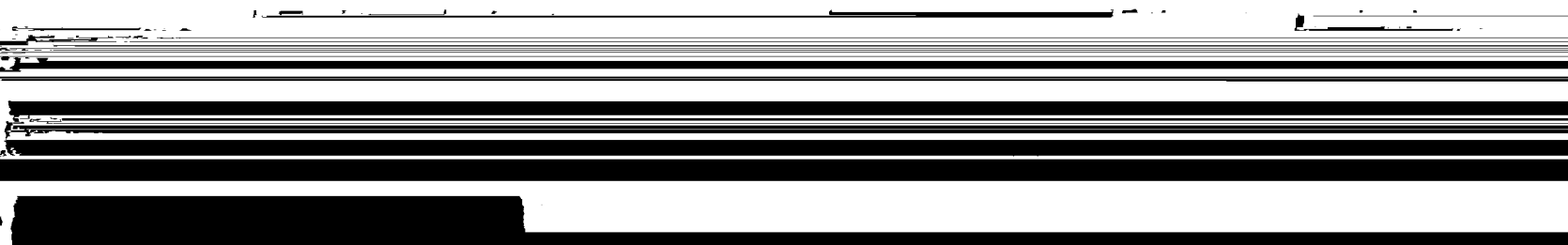


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return on their investment for plant in service. Additionally, the Commission is interested in simplifying carrier recordkeeping.⁴

Many of the parties fail to fully address these basic concerns. The LECs are particularly biased and shallow in their analysis, in a transparent attempt to tip the



I. CURRENT RATEPAYERS SHOULD NOT BE BURDENED WITH THE COSTS OF FUTURE CONSTRUCTION

Several parties recommend that the Commission adopt the Ratebase Method or the Revenue Offset Method for long term PUC (PUC-LT), short-term PUC (PUC-ST) or both,⁵ even though the Ratebase Method and, to a lesser degree, the Revenue Offset Method, imposes charges on current ratepayers for future construction.⁶ Most parties do not dispute the inherent inequity of this result. Nonetheless, they support charging current ratepayers for future construction - - not because it is fair, but because, allegedly, the unfairness will be immaterial or is justified by other factors.

As a preliminary matter, the Commission has already determined that charging current ratepayers for future construction is not in the public interest and, particularly with respect to PUC-LT, conflicts with long-established law and policy. In Docket No. 19129,⁷ the Commission concluded that long-term construction projects were not useful to current ratepayers and, therefore,

⁵ BellSouth and the Florida PSC recommend that the Commission adopt the Ratebase Method for both PUC-LT and PUC-ST. See, BellSouth at 3-6, Florida PSC at 3-4. SNET and the PSCW recommend that the Commission retain the Ratebase Method for PUC-ST only. SNET at 2-3, PSCW at 4, 6. Ameritech, NYNEX and Southwestern Bell support the Commission's proposal to use the Revenue Offset Method for both PUC-ST and PUC-LT. Ameritech at 2, NYNEX at 2-4, Southwestern Bell at 3-4. NECA and NTCA qualify their support of the Revenue Offset Method, requesting that the Ratebase Method continue to be used where AFUDC is "immaterial." NECA at 4. SNET at 3-4.

"... investors are not necessarily entitled to receive from the ratepayers the rate of return prescribed for it until the plant is placed into service."⁸ This conclusion addressed the concern that when projects were abandoned, there was "no practical way . . . to make current ratepayers whole."⁹ Clearly, it is unreasonable for current ratepayers to pay for investment that may, as a practical matter, never become used and useful for the provision of telecommunications service.

Some parties allege that investors should recover some or all of their return from current ratepayers to be made whole.¹⁰ This is simply unnecessary. Investors would be fully compensated through the Capitalization Method, which also maintains the important distinction between current and future ratepayers. With the Capitalization Method, investors receive the full rate of return on both the investment and the accumulated interest on that investment when the plant is put into service. Evidence suggests that no carrier has experienced difficulty in attracting investors or funding long-term construction projects under these

⁸ Id. at 60. The Commission also noted: "We find it unreasonable and clearly not in the public interest for AT&T or this Commission to burden current ratepayers with a project (e.g. construction of a new coaxial cable) that will not be placed into service for 5 to 8 years. While most AT&T construction projects are completed within one year, many of the longer term projects involve large capital investments and thus can have a significant rate-base impact. We believe it is reasonable to separate such large, costly, longer-term projects from the smaller, less costly, short-term projects. To this extent, we find it both feasible and necessary to distinguish between current and future ratepayers." Id. at 59.

⁹ Id. at 57.

¹⁰ See, e.g. Ameritech at 2.

rules.¹¹ Thus, there is no reason to encumber current ratepayers with excessive cost recovery in order to "protect" the interests of investors.

BellSouth and the Florida PSC claim that the amount of AFUDC is so small, that the Ratebase Method can be used for all PUC with immaterial effects on current ratepayers, and that it would therefore be consistent with GAAP.¹² This assertion is simply incorrect. Regional Bell Operating Company (RBOC) Form M reports indicate significant PUC-LT and even greater amounts for PUC-ST.¹³ Thus, using the Ratebase Method would materially and unfairly impact current ratepayers and would be inconsistent with GAAP requirements for the capitalization of construction interest.

BellSouth claims, additionally, that Ameritech's analysis demonstrates that the Rate Base Method is in the interest of ratepayers in the long term.¹⁴ However, as MCI pointed out in its Opposition to Ameritech's Petition for Rulemaking, Ameritech's analysis was fatally flawed and self-serving.¹⁵ Thus,

¹¹ As MCI noted, the RBOC Form M reports indicate funds in excess of a billion dollars are devoted to PUC-LT. (Data accumulated from the RBOC 1991 Form M Reports, Schedule B1.)

¹² BellSouth at 5, Florida PSC at 3-4.

¹³ BellSouth's Form M report indicates that it currently may have a balance in PUC-LT that is low compared to other RBOCs. The Commission must be concerned about future construction plans, which BellSouth has failed to delineate, as well as PUC balances of other LECs. RBOC Form M reports indicate over a billion dollars is dedicated to PUC-LT, and around 2 billion dollars is devoted to PUC-ST. Thus, BellSouth's arguments on materiality are unpersuasive. (Data accumulated from the RBOC 1991 Form M Reports, Schedule B1.)

¹⁴ BellSouth at 3-4.

¹⁵ Ameritech's clerical errors and manipulation of the revenue requirements under the two alternatives biased the results displayed in its Petition for Rulemaking. See MCI Opposition to

this argument is unpersuasive. BellSouth also alleges that the Ratebase Method will reduce administrative costs.¹⁶ However, the construction and depreciation of assets involves so many accounting procedures that the additional bookkeeping entries for capitalizing interest are de minimis in comparison. In any event, the minor costs of these procedures are far outweighed by the benefits of assuring that current ratepayers are treated fairly. Finally, BellSouth argues, without presenting any evidence, that the "elimination of 'paper income' in the form of capitalized interest will enhance investors' perception of the quality of carrier earnings, thereby reducing capital costs over time."¹⁷ BellSouth's conclusion is counterintuitive, as investors are generally savvy as to the impact of "paper" transactions. Thus, BellSouth has presented no valid reason why any inequity to current ratepayers should be tolerated. The Commission should, therefore, decline to allow use of the Ratebase Method or the Revenue Offset Method, particularly with respect to PUC-LT. In fact, use of the Capitalization Method alone for all PUC would assure that current ratepayers and future ratepayers are consistently treated in an equitable manner, while investors are appropriately compensated.

For PUC-ST, the Commission initially adopted the Ratebase Method in Docket No. 19129, concluding that, due to the short time lag (one year or less) for placing the investment into service, current ratepayers absorbing the costs of construction and future ratepayers receiving the benefits of construction were

¹⁶ BellSouth at 4.

¹⁷ Id.

likely to be one and the same.¹⁸ Thus, the Commission found it neither "practical" nor "necessary" at that time to distinguish between current and future ratepayers for purposes of PUC-ST.¹⁹ Some parties assert that the Commission should continue this practice. For example, PSCW argues that "the reasons used by the FCC to differentiate between long and short-term construction projects in 1967 still exist today and are still appropriate."²⁰ MCI disagrees.

First, there is no evidence on the record as to whether or not ratepayers are likely to be the same from one year to the next. One event that has changed the LEC ratepayer base considerably since 1967 is the introduction of competition into the interexchange market. As the market became more and more competitive, many more ratepayers are entering and leaving the market, and those who remain are less likely to retain the same market share from year to year. Thus, using the Ratebase Method (or Revenue Offset Method) for PUC-ST, ratepayers will, in all likelihood, receive the benefits of investment to a far different degree than they absorb the costs of the investment. For these reasons, the inequity to current ratepayers of using the Ratebase Method for PUC-ST could be material, and distinction between current and future ratepayers is now even more critical.

Distinguishing between current and future ratepayers for PUC-ST can be accomplished by using the Capitalization Method for all PUC, which is also the

¹⁸ Docket No. 19129 at 59.

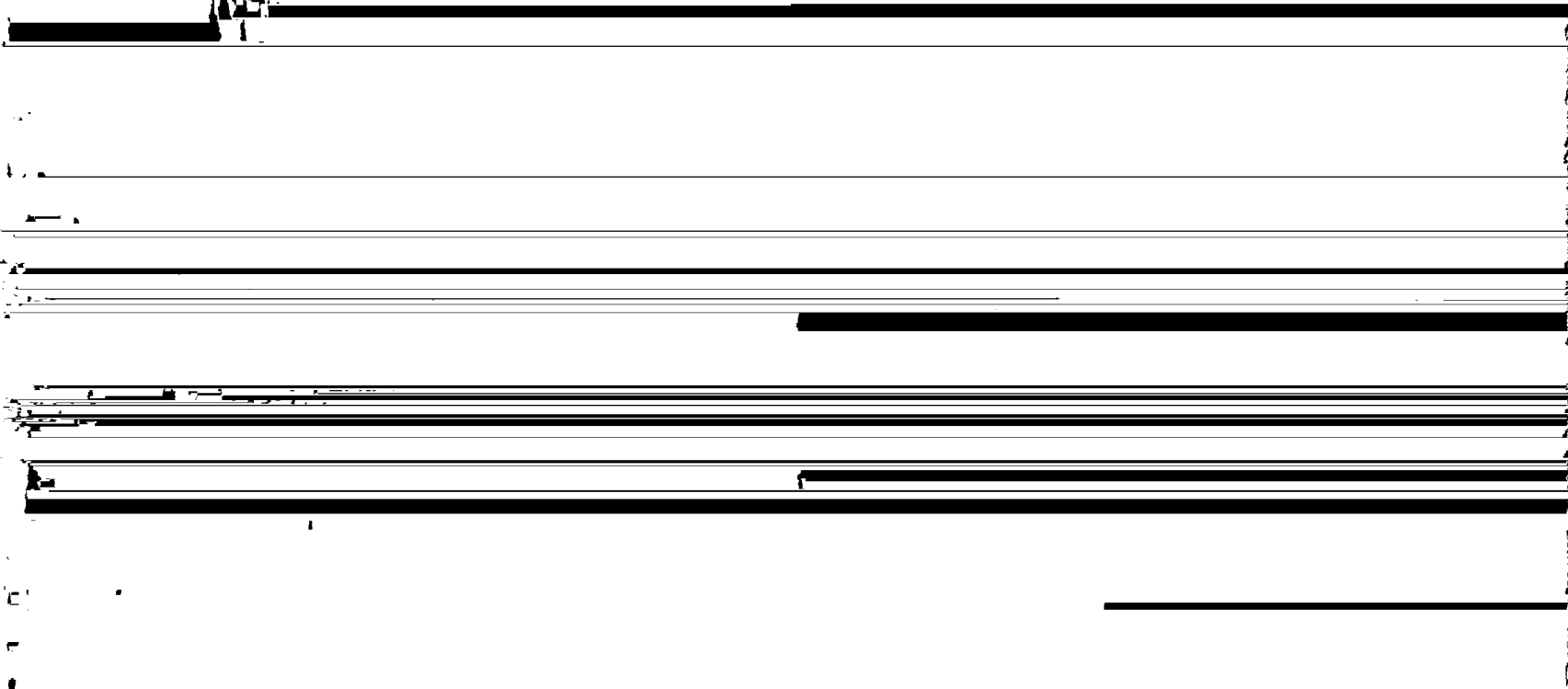
¹⁹ Id.

²⁰ PSCW at 4.

most practical solution. Treating all PUC consistently is less administratively burdensome than continuing the dichotomy between PUC-ST and PUC-LT. It is also the one method clearly compatible with GAAP, which contemplates capitalization of construction interest with no distinction between PUC-LT and PUC-ST.²¹ Further, the current dichotomy, i.e., use of the Ratebase Method for PUC-ST and capitalization of interest for PUC-LT, creates incentives for the LECs to underestimate the time of completion for construction projects so that the costs can be included in the current ratebase. Consistent use of the Capitalization Method will eliminate these incentives. MCI, therefore, urges the Commission to require the Capitalization Method for PUC-ST as well as PUC-LT.

II. ACCRUING AFUDC AT OTHER THAN THE PRIME RATE IS NOT IN THE PUBLIC INTEREST

The public interest in the prompt deployment of low-cost telecommunications plant weighs in favor of continuing the use of the prime rate rather than adopting the cost of debt or weighted cost of capital as proposed by



AFUDC is, instead, designed to allow investors to recover the reasonable costs of construction. Thus, the Commission has repeatedly required "reasonable interest" as the appropriate benchmark rather than some possibly more expensive LEC determination of the appropriate funding.²³

Those who advocate use of the cost of debt for AFUDC argue that it is consistent with GAAP.²⁴ However, as PSCW recognized,

The question that needs to be answered, regarding the rate to be used to compute AFUDC, is whether conformity with GAAP should prevail over consistency with regulatory needs. This was recognized by the FCC in docket 84-469. In that proceeding the FCC adopted GAAP in the USOA to the extent possible consistent with regulatory needs.²⁵

In this instance, the public interest in the prompt deployment of low-cost telecommunications plant clearly outweighs any administrative burdens involved with separate recordkeeping. The prime rate represents the cost to good corporate borrowers of short-term funds -- those normally used in construction. Carriers are, thus, encouraged to build quickly and manage their borrowings to remain eligible for the prime rate. Any other measure would reflect capital borrowings for non-regulatory as well as regulatory purposes. In short, allowing the LECs to determine their own measure of interest is likely to result in the inflation of costs to ratepayers, while retaining the short-term interest rate (prime interest rate) for PUC

²³ The court, in *Communications Satellite Corp. v. FCC*, 611 F. 2d 883, 895-97 (D.C. Cir. 1977) (Comsat), found that the actual funding sources that Comsat used were irrelevant. In fact the Commission had the prerogative to impute a reasonable capital structure. 56 FCC 2d 1160 (1975).

²⁴ See, e.g., *Ameritech* at 2, *NYNEX* at 3, *Southwestern Bell* at 2.

²⁵ *PSCW* at 2.


will further the Commission's goal of encouraging timely completion of construction projects and will appropriately compensate the LECs for the investment in construction projects.²⁸ Thus, MCI urges the Commission to require the use of the prime rate to capitalize interest on both PUC-LT and PUC-ST.

III. CONCLUSION

Using the Capitalization Method and capitalizing interest at the prime rate with respect to all PUC would be the only method which would appropriately balance the interests of investors and ratepayers (current and future), while maintaining administrative simplicity. MCI, therefore, respectfully requests that the Commission adopt the Capitalization Method, capitalizing interest at the prime rate, for both PUC-LT and PUC-ST.

Respectfully submitted,

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Dated: May 28, 1993

²⁸ In fact, the PSCW acknowledged that it allowed Wisconsin Bell to use the prime rate "due to the immaterial difference in the impact of using the weighted cost of capital versus the prime rate. . ." PSCW at 1.

CERTIFICATE OF SERVICE

I, Susan Travis, do hereby certify that copies of the foregoing MCI Reply Comments were sent via first class mail, postage paid, to the following on this 28th day of May 1993:

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